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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

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September 14, 1994

Mr. William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, N.W. Room 222  
Washington, D.C. 20554

RE: In the Matter of Price Cap Performance Review for Local  
Exchange Carriers, CC Docket No. 94-1

Dear Mr. Caton,

Today, the undersigned and the following representatives  
of Sprint Corporation participated in a meeting to discuss issues  
in the above referenced docket:

Mr. Jim Sichter	Mr. Ric Kapka
Mr. John Ivanuska	Mr. Pete Sywenki

Participating from the Common Carrier Bureau's Tariff  
Division were:

Mr. Dan Grosh	Ms. Joanne Wall
Mr. Anthony Bush	Mr. Alex Belinfante

Information on the attached pages, relative to Sprint's  
comments and reply comments submitted on May 9 and June 29, 1994,  
respectively, was discussed. Sprint asks that this information  
be added as part of the record in this matter.

Sincerely,

Warren D. Hannah

Attachment

cc: Mr. Jay C. Keithley, SUMC, Washington, D.C.  
Mr. Alan J. Sykes, SUMC, Kansas City  
All participants

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# **SPRINT PRICE CAP REFORM PLAN**

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**FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY**

# **SPRINT PRICE CAP REFORM OBJECTIVES**

## **OBJECTIVE**

- **INCREASED CONSUMER BENEFITS**
- **INCREASED INCENTIVES FOR PRODUCTIVITY/INFRA-STRUCTURE INVESTMENT**
- **MEASURED STEPS TO ENHANCE LEC's COMPETITIVENESS**

## **Achieved Through:**

- **Access Rate Reductions Greater Than Existing Price Cap Plan**
- **Higher Productivity Offset**
- **Elimination Of Sharing**
- **Immediate Implementation Of Zone Density**
- **Targeted Reductions To High Density Zone Rates**
- **Transport Residual Interconnection Charge (RIC) Phaseout**

# **SPRINT PRICE CAP REFORM PLAN OVERVIEW**

- **5 Year Plan**
- **Incremental Modification Of Existing Price Cap Plans**
  - **More far-reaching access reform (e.g., USTA proposal) not appropriate or necessary at this time**

## **Key Changes To The Existing Price Cap Plan**

- **4.5% Productivity Offset**
- **2% Upfront Rate Reduction**
- **Elimination Of Sharing/Lower Formula Adjustment Mark (LFAM)**
- **Immediate Implementation Of Zone Density**
- **RIC Phase-down**
- **Per Line Cap For CCLC**

# **PRODUCTIVITY PROPOSAL**

- **Retain The 2.8% Base Productivity Factor**
- **Add A Consumer Productivity Dividend (CPD) Of 1.7%**
  - **CPD to be targeted to transport RIC reductions**
  - **When, and if, RIC is completely phased out, CPD applied to all remaining price cap services**
- **If, As Sprint Advocates, The Commission Adopts A Per Line Cap For The CCLC, The Base Productivity Factor Of 2.8% Should Be Reduced To 2.0%**
  - **Based on AT&T's estimate that the per line cap equates to a .8% productivity offset relative to the existing corrective formula**

# **RIC PHASE DOWN METHODOLOGY**

- **The Transport RIC Should Be Placed, By Itself, In A Separate Basket**
  - **The RIC could be redefined to exclude the 80% of tandem costs now incorporated into the RIC. If this is done, Sprint advocates that these tandem costs be moved to the local switching basket.**
- **The RIC Phasedown Would Be Effected Through The Following Process:**
  - **The 1.7% CPD would be applied to the LEC's base year revenue to determine the dollar value of the RIC reduction**
  - **The dollar value of the RIC reduction would be included as an exogenous cost change in calculating the PCI change for the transport RIC basket**

# RIC PHASEDOWN EXAMPLE

## Assume:

RIC = \$.005/Minute

MOU = 20,000,000

RIC Base

Year Revenues (R) = \$100,000

RIC PCI = 100

Total Price Cap Base Year Revenue = \$1,000,000

Inflation = 3.0%

Productivity = 2.8%

## RIC PCI Calculation:

$$PCI_t = PCI_{t-1} [1 + W (GN PPI - X) + \Delta Z/R]$$

$$PCI_t = 100 [1 + .83 (3.0\% - 2.8\%) + (-\$17,000/\$100,000)]$$

## Where:

$$\Delta Z = 1.7\% \times 1,000,000 = \$17,000$$

$$W = (100,000 - 17,000)/100,000 = .83$$

$$PCI_t = 100 [1 + .00166 - .17]$$

$$PCI_t = 83.166$$

## RIC Rate Reduction:

$$\Delta PCI = -16.834\%$$

$$\text{New RIC Rate} = \$.004158/\text{Minute}$$

# RIC PHASEDOWN IMPACTS (SPRINT LTD)

	<u>Total</u>	<u>Total RIC Less Tandem Costs</u>
<b>RIC Revenues (1993)</b>	<b>\$81.7M</b>	<b>\$62.6M</b>
<b>Total Price Cap Revenues</b>	<b>\$898M</b>	<b>\$898M</b>
<b>Dollar Value Of CPD (1.7%)</b>	<b>\$15.3M</b>	<b>\$15.3M</b>
<b>Annual Percent RIC Reduction Due To CPD</b>	<b>19%</b>	<b>24%</b>
<b>Years Needed To Eliminate RIC</b>	<b>5.3</b>	<b>4.1</b>



# **RIC PHASEDOWN IMPACTS**

## **(Industry)**

	<b><u>Total</u></b>	<b><u>Total RIC Less Tandem Costs</u></b>
<b>RIC Revenues (1993)</b>	<b>\$2,618M</b>	<b>\$2,277M</b>
<b>Total Price Cap Revenues</b>	<b>\$20,258M</b>	<b>\$20,258M</b>
<b>Dollar Value Of CPD (1.7%)</b>	<b>\$344M</b>	<b>\$344M</b>
<b>Annual Percent RIC Reduction Due To CPD</b>	<b>13%</b>	<b>15%</b>
<b>Years Needed To Eliminate RIC</b>	<b>7.6</b>	<b>6.6</b>

## **2% UPFRONT RATE REDUCTION**

- **Upfront Rate Reduction Calculated As 2% Of Base Year Revenues**
- **Dollar Value Of Upfront Rate Reduction Targeted To:**
  - **Zone 1 and Zone 2 dedicated and tandem switched transport rates**
    - » **Proposed rates must meet criteria for below band filings (i.e., must equal or exceed average variable costs)**
    - » **LEC's not required to price down to floor price (i.e., the plan provides an opportunity to price transport services more competitively; it does not mandate a LEC to reduce transport rates if the LEC believes existing rates are already competitive)**

**AND/OR**

- **Reductions to the CCLC**
- **Sprint's Proposal Requires Immediate Implementation Of Zone Density**
  - **No prerequisite of operational expanded interconnection**
  - **Applicable to Tier 2 as well as Tier 1 Companies**

# **METHODOLOGY FOR FLOWING THROUGH 2% UPFRONT RATE REDUCTION**

- **Zones Initialized For Switched and Special Transport Services**
  - DS1
  - DS3
  - Tandem Switched Transport
- **Dollar Value of Upfront Rate Reduction Calculated As 2% of Total Base Year Price Cap Revenues (R)**
- **Proposed Transport Rate Reductions Require Cost Showing That The Proposed Rate Equals or Exceeds Average Variable Costs (below band filing requirement)**
- **Dollar Value of Rate Reductions Calculated Using Base Year Demand**
  - Treated as exogenous cost change in trunking basket PCI
  - SBIs of non-zone density service categories not affected
- **If Dollar Value of Proposed Transport Rate Reductions Is Less Than Dollar Value of 2% Upfront Rate Reduction, Remainder is Applied To The Common Line Basket**
  - Treated as exogenous cost change in reducing Common Line PCI

## 2% Up-Front Reduction / Zone Density Example

$$R(t-1) = 200,000,000$$

$$2\% = 4,000,000$$

	<u>Current Rates</u>	<u>Price Floor (avg. var cost)</u>		<u>Proposed Rates</u>		<u>Revenue Reduction (proposed - current)</u>		
	<u>No Zone Density</u>	<u>Zone 1</u>	<u>Zone 2</u>	<u>Zone 1</u>	<u>Zone 2</u>	<u>Zone 1</u>	<u>Zone 2</u>	<u>Total</u>
VG	\$240	\$110	\$220	\$150	\$230	\$425,000	\$125,000	\$550,000
DS1	\$830	\$370	\$740	\$400	\$750	\$700,000	\$375,000	\$1,075,000
DS3	\$5,900	\$2,630	\$5,260	\$2,700	\$5,300	\$250,000	\$150,000	\$400,000
TST	\$ .002	\$ .0009	\$ .018	\$ .001	\$ .0019	\$500,000	\$150,000	\$650,000
						<u>\$1,875,000</u>	<u>\$800,000</u>	<u>\$2,675,000</u>

$$\text{Amount Available for CCL Reduction} = \$4,000,000 - \$2,675,000 = \underline{\underline{\$1,325,000}}$$

## **Consumer Benefit**

### **Long Distance Volumes Have Increased Significantly**

- **Between 1Q88 And 1Q94, Sprint, AT&T And MCI Long Distance Minutes Increased From 41.3 Billion Per Quarter To 72 Billion Per Quarter.**

### **As Long Distance Prices Declined Substantially**

- **During The Same Period, Revenue Per Minute Of Sprint, MCI And AT&T Declined From 25.61¢ to 18.43¢.**

**Driven Partly By An Approximate 5.11¢ Decline In LD Access Expense/MOU**

## **Consumer Benefit (cont'd.)**

**Declining Long Distance Access Expenses Result From Three Factors:**

- Access Efficiencies (e.g., Hubbing/Grooming, etc.)**
- LEC Net Access Rate Reductions**
- IXC Product Mix (e.g., Selling Proportionally More VPN)**

**BOC Net Access Rate Reductions Have Totaled 1.39¢/MOU Between 1988 And 1992.**

**Access Charge Reductions Accounted For Approximately 20% Of Total Long Distance Price Reductions Experienced During The 1988-1994 Time Period.**

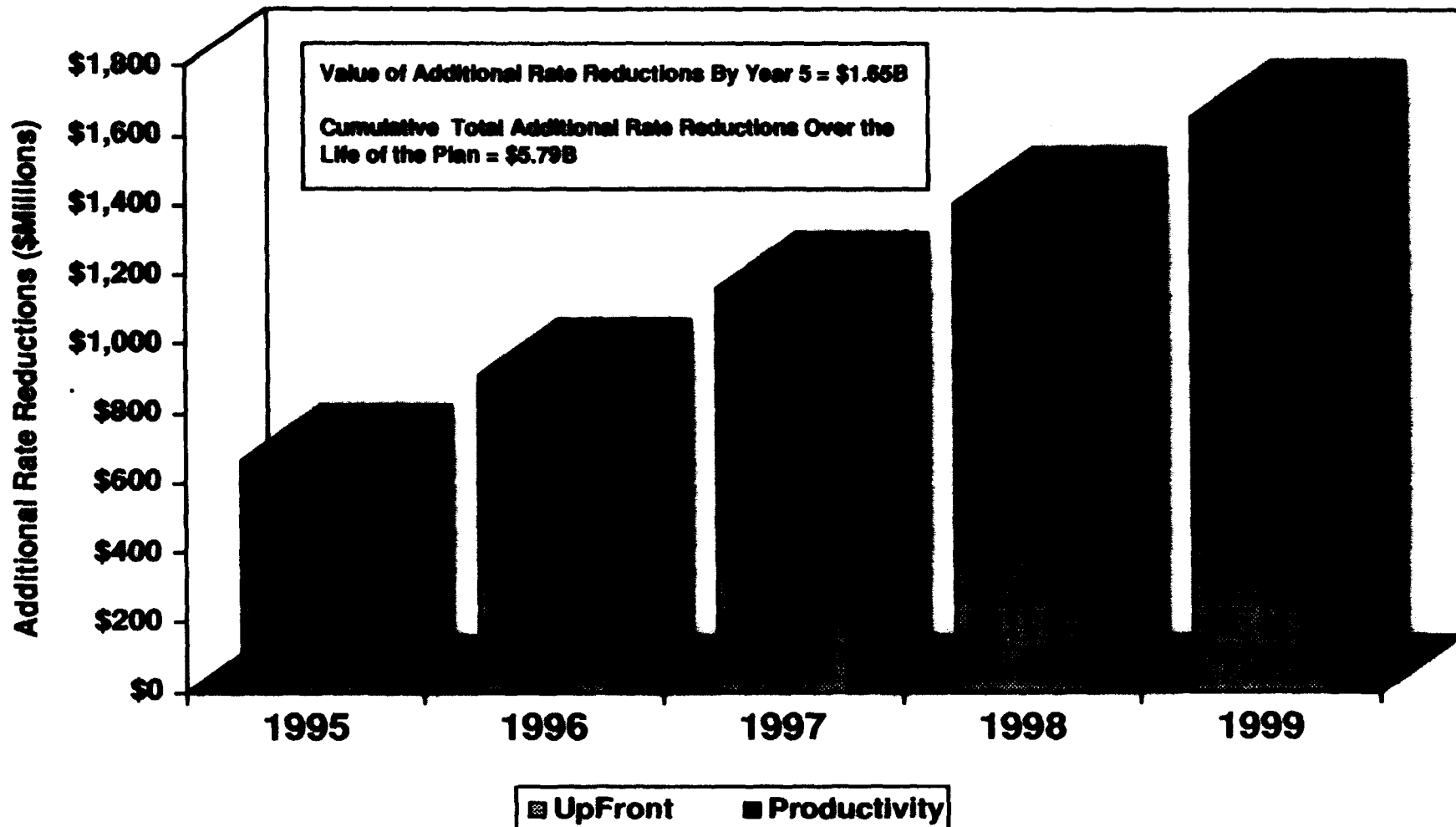
## **Consumer Benefit (cont'd.)**

**LEC Net Access Rate Reductions Since 1988 Led To Consumer Benefits (Lower Long Distance Prices) Of Approximately \$3.7 Billion During 1993.**

***Sprint Price Cap Proposal Reductions Would Exceed Reductions Under The Current Plan By An Additional \$5.97 Billion Over The 1995-1999 Time Period.***

# Access Rate Reductions Under The Sprint Price Cap Plan

Compared to the Existing Price Cap Plan\*





# **ACCESS RATE REDUCTIONS UNDER THE SPRINT PRICE CAP PLAN Compared to the Existing Price Cap Plan \***

<b>Value Of 2% Upfront Rate Reduction</b>	<b>\$413M</b>
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**Value Of Higher Productivity  
Offset (4.5% vs. 3.3%)**

<b>- Annual Rate Reduction</b>	<b>\$248M</b>
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<b>- Rate Reductions Over 5 Years</b>	<b><u>\$1,240M</u></b>
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<b>Total Value Of Additional Rate Reductions By The 5th Year Of The Plan</b>	<b>\$1,653M</b>
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<b>Cumulative Total Additional Rate Reductions Over The Life Of The Plan</b>	<b>\$5,785M</b>
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**\*Based On Total Industry 1993 Price Cap Revenues Of \$20.6B**

# **ELIMINATION OF SHARING/LFAM**

- **Breaks Last Link To ROR Regulation**
- **Trade-off For Higher Productivity/Upfront Rate Reduction**
- **Benefits From Eliminating Sharing**
  - **Strengthened incentives for efficiency**
  - **Diminished incentives for cross-subsidization**
  - **Reduces administrative complexity of price cap regulation**
  - **Establishes framework to accommodate further access reform of rule changes to reflect intensified competition; for example:**
    - » **Increased downward pricing flexibility**
    - » **Selective deregulation of services deemed to be fully competitive**
    - » **Risks and rewards of new service offerings or voluntary infrastructure development (e.g., video dial tone) borne entirely by LEC**

# OTHER PRICE CAP REFORM ISSUES

## ISSUE

- **BASKETS AND BANDS**
- **EXOGENOUS COST CHANGE RULE**
- **INFRASTRUCTURE DEVELOPMENTS**
- **RATE OF RETURN REPRESRIPTION**
- **NEW SERVICES**
- **SERVICE QUALITY, INFRASTRUCTURE MONITORING, AND NETWORK RELIABILITY**

## SPRINT's POSITION

- **No Changes in Access Baskets and Bands Beyond Those Needed To Implement Zone Density and the RIC Phase-down**
- **IX Basket Should Not be Subject to Price Caps (Cap Rates at Existing Levels)**
- **Oppose Proposal to Differentiate Between "Accounting" and "Economic" Cost Changes**
- **Continue Case-by-Case Review**
- **Sprint Reform Plan Provides Appropriate Incentives**
- **Oppose Mandates**
- **Moot Issue With Elimination of Sharing**
- **Even Without Elimination of Sharing, 11.25% Still Reasonable**
- **No Change in Rules Needed at This Time**
- **Current Reporting Requirements Are Adequate**